



THE TAX INSTITUTE

4 July 2014

Mr David Monk
Committee Secretariat
Standing Committee on Tax and Revenue
House of Representatives
PO Box 6021
Parliament House
Canberra ACT 2600

By email: taxrev.reps@aph.gov.au

Dear Mr Monk,

Inquiry into Tax Disputes

The Tax Institute welcomes the opportunity to make a submission to the House of Representatives Standing Committee on Tax and Revenue (**the Committee**) in relation to its Inquiry into Tax Disputes.

Executive summary

1. Given the broad terms of this Inquiry, we have focussed in this submission on those aspects of tax disputes that are of particular interest or relevance to our members.
2. In summary, the main conclusions of this submission are as follows:
 - (a) Over approximately the past 18 months, our members have noticed genuine and significant improvements in the way that tax disputes are handled by the Australian Taxation Office (ATO);
 - (b) Nevertheless, there remains room for improvement in a number of areas, including:
 - (i) Engagement and cooperation at review and audit stage;
 - (ii) Flexibility in internal ATO timeframes, in particular to avoid the unnecessary escalation or progression of a matter that may otherwise have been resolved or limited;

- (iii) Opportunities for early engagement and resolution outside of the large business and high wealth individual (HWI) areas;
 - (iv) Technical expertise within the ATO; and
 - (v) Independence at objection and independent review stages;
- (c) Structural change to the way that objections, reviews and litigation are managed within the ATO may be constructive. On balance, the Institute supports the establishment of a separate appeals area within the ATO; and
- (d) As part of this review, the Committee may wish to consider a review of the decades-old statutory regime that currently governs tax disputes.
3. The Institute, along with its expert members in the area of dispute resolution, would be pleased to assist the Committee further, either by providing additional details on matters set out in this submission or by addressing the Committee more generally.

Reviews and audits

4. In general, our members have observed positive changes in the way that reviews and audits are conducted by the ATO. Nevertheless, we have identified a number of areas for improvement, which are set out below.

Review and audit timeframes

5. Members have observed that audits can often extend for long periods of time, creating ongoing expense and commercial uncertainty for taxpayers. It is acknowledged that in some cases, this may be due to difficulties faced by audit officers in collecting information or engaging with a taxpayer.
6. On the other hand, there is a concern that review or audit processes are sometimes unnecessarily escalated or progressed because officers are subject to internally-imposed timeframes, rather than because of any external requirements or factors. For example, a requirement that a risk review be completed within a certain period of time. This can send the wrong message to a taxpayer who is willing to engage with the ATO and may lead to both parties incurring costs in dealing with steps or processes that may otherwise have been unnecessary. Accordingly, a more flexible approach to internal timeframes may be warranted.

Engagement and escalation

7. Across all sectors, our members report that audit teams are often reluctant to discuss the legal issues in dispute. Whilst acknowledging that some disputes involve difficult issues concerning the interpretation of the law (rather than just the application of the law to the facts), any productive discussions in such disputes are often seen only after matters have been escalated beyond the audit team. Such escalation can take a number of weeks or months, further delaying the prompt resolution of disputes. Importantly, our members have found that face-to-face discussions with technical specialists (rather than through the prism of a position paper) at the audit stage have been beneficial in clarifying and sometimes resolving the issues in dispute.
8. There is also concern amongst members that officers have a tendency to try to fit taxpayers into a formal process, which can limit the benefits in terms of flexibility and informality that is otherwise present in early engagement.
9. Other matters that the Committee may wish to consider are expeditious findings of fraud or evasion to permit amendments out of time, threats of protective assessments to draw out extensions of the audit period, use of debt collection and departure prohibition orders to force outcomes and multiple assessments to different taxpayers. All of these add to discord in the audit process and, in some instances, are vigorously sought to be defended in any later review or appeal process.

Independence

10. The Institute is concerned that there is currently a perception within the ATO that technical experts within the ATO, for example those from the Tax Counsel Network, who advise the audit team and are involved in the initial stages of a matter can participate in large business independent reviews.
11. Our experience is that even though the independent reviewer may have the requisite level of independence, he or she will often look to the member of the Tax Counsel Network for advice on interpretational issues. The Tax Counsel's participation in both the audit and review processes is inconsistent with the principle of full and true independence and should be considered by the Committee, for example in the context of creating a separate disputes agency or area within the ATO. A separate appeals and review area could address the concern regarding independence.

HWI and small to medium segments

12. The experience of our members representing taxpayers in the HWI and small to medium segments is that audit activities may take a long time and the duration of the audit in itself generates spasmodic engagement on the part of the audit team related to particular issues with which they are then engaged. The process is often iterative rather than organic from a first principles approach. This often results in an early position being adopted by an ATO officer or audit team involved based on information available at an early

stage in the audit process, without a fresh case review being taken of all of the information available at a point in time shortly prior to the ATO delivering its position paper in respect of the audit. This extends the duration of audits and adds to cost and complexity. Engagement with the audit team on HWI and small to medium segment audits, in particular, has historically been adversarial, however, practitioners have generally (but not universally) experienced a more co-operative approach in recent times. Our members find the co-operative approach often reduces the cost and duration of the audit and is to be commended.

Large business segment

13. The recently introduced independent review and other early engagement processes have, in general, assisted in the earlier clarification of the legal issues in dispute and are welcomed.
14. Annual compliance arrangements (ACAs) have generally been a significant improvement in the area of engagement with large business. Engagement with these processes usually involves a significant investment of resources on the part of the taxpayer and this needs to be balanced with the degree of certainty that can be provided by the ATO and how quickly it can be provided. Some taxpayers have been satisfied with these processes and others less so, which may be a sign of lack of uniformity and clarity. For example, no model ACA is available. Because these programs are still relatively new, a review would be useful to ensure that full potential is derived.
15. The Institute understands that about half of all independent review processes have been decided in favour of the taxpayer. Although this is positive in demonstrating that officers are willing and able to engage with the issues, it also raises questions and may show a deficiency either in the amount of information provided by the taxpayer prior to the position paper being prepared or a need to improve the position paper process more generally. For example, there may be merit in more dialogue between the audit team and taxpayer prior to the position paper being issued, or greater flexibility in timeframes for position papers being issued, so as to avoid papers being issued before all information is obtained.
16. Our members in the large business sector also experience audits that take too long to resolve and in some cases, the number of concurrent audits of the same taxpayer needs to be streamlined having regard to the limited resources of both the taxpayer and the ATO.

Individuals and other small taxpayers

17. In particular, there is some concern that much of the attention in terms of early engagement and dispute resolution has been focussed on the HWI,

small to medium and large business segments, but that smaller taxpayers, including individuals, have not been receiving the same opportunities.

Collection and recovery

18. Our members have observed that junior collection officers, who are often the initial engagement point in matters relating to collection and recovery, can be inflexibly focussed on process and have a tendency to apply ATO policies in a way that is perfunctory, mechanical and often uncompromising. Officers may also not be aware of or not take into account a taxpayer's individual circumstances, which may be caused by a lack of coordination with other areas of the ATO (such as an audit team or legal services).
19. More reasonable outcomes are often achieved after matters are escalated to more senior officers. However, this is often only after the taxpayer has incurred unnecessary time and costs. There is also concern that individual and smaller taxpayers in particular do not have the resources or ability to escalate such matters, which may result in key differences in the application of collection policies to taxpayers in those segments.
20. In terms of engagement in collection disputes, it is currently common for collection officers to be located in a different state to where a taxpayer and its advisors are located. This creates practical difficulties in terms of being able to have face-to-face meetings (which are often a more expeditious way to resolve disputes) and the Committee may wish to consider encouraging greater geographical alignment in this respect.
21. Also, the ATO has wide ranging powers which enable it to hold directors personally liable for certain tax debts of companies. The Institute is concerned that the application of these provisions can unfairly expose directors to liabilities of the company when they would not reasonably be expected to have known that these tax debts were not being paid. For example, a finance manager may, in order to improve the cash flow of the company and without the knowledge of the directors, decide not to pay PAYG(W) amounts to the ATO. Such situations expose directors to personal liabilities. The Committee may wish to examine the scope of these provisions to ensure that they operate as intended and do not hold directors personally liable for obligations they could not reasonably have known were not being paid.

Expertise within the ATO

22. There are some areas of the tax law that pose a higher inherent risk profile or are, by their nature, uncertain. Such areas include transfer pricing and valuation matters.
23. Whilst the ATO's focus on ensuring a greater number of officers have general transfer pricing knowledge is commendable, The Tax Institute is concerned

that the ATO has lost a great deal of transfer pricing expertise in recent years. The disbanding of the ATO's Transfer Pricing Practice and the recent decision to withdraw the Transfer Pricing Review Panel Practice Statement suggests a trend which might lead to a lack of consistency in the application of the transfer pricing provisions or an inability to identify transfer pricing risks. The Committee may wish to consider whether further investment is required in this area or an examination of the ATO's approach to potential risks associated with the transfer pricing rules. These matters are also addressed to some extent in the IGOT's recent review into the ATO's management of transfer pricing matters.

24. In relation to valuation matters, there are a significant number of tax provisions which rely upon market values or the valuation of a thing. Such provisions lend themselves to tax controversy which are often difficult to resolve in a timely and cost effective manner. The ATO, through its Dispute Resolution Working Group, is looking for ways in which to improve the resolution of market valuation disputes. This work should be commended, however, it might be that a review of the myriad of legislative provisions requiring taxpayers to establish 'market value', which is an uncertain concept, is necessary in order to reduce the number of disputes arising in this area.

Establishing a separate agency or appeals area to manage ATO disputes

25. The media release that announced this Inquiry presented three options for dealing with ATO disputes in the future, being:
- (a) to establish a separate agency to manage ATO disputes;
 - (b) to establish a separate appeals area within the ATO; or
 - (c) to continue with current arrangements.
26. Although the ATO has come a long way in terms of its handling of disputes and has introduced a number of positive measures, structural (rather than operational) change is desirable to provide for the years to come. Accordingly, as a matter of principle, the Institute considers that the appeals and review functions of the ATO should be separate from its other functions, albeit still part of the ATO rather than being a separate agency. In particular, we consider that full and true independence of these functions would ultimately increase efficiency and reduce costs for both parties and reduce the incidence of matters escalating to litigation. The appeals and review area should be able to become involved at the audit position paper stage if requested by a taxpayer. This area should be able to be called upon prior to the objection stage so that the audit team is not required to issue an assessment before the review can take place. It is important that the existence of the review and appeals area does not encourage decision-making which is adverse to the taxpayer at the audit stage and the availability of referral to that area pre-objection should ameliorate this concern.

27. We think that a properly resourced and independent area *within* the ATO, established with appropriate legislative support, would be sufficient and may reduce the costs of setting up and running a separate agency. Such an area should have independent technical officers that specialise in the determination and resolution of disputes.
28. The Institute has concerns about whether the ATO currently has sufficient suitably experienced people to create such a separate function. Accordingly, it is important that any structural change is supported with sufficient appropriately trained staff to allow this area to be run properly.

Aligning legislation with ATO administrative practice

29. The legislative regime that currently governs tax disputes has been around for many decades, during which time the tax and commercial landscape and the administrative processes and structure of the ATO have changed dramatically. Accordingly, the Institute considers that this legislative regime should now be revisited.
30. Examples of proposed legislative improvements include:
 - (a) Allowing greater flexibility for the ATO and taxpayers to resolve disputes informally by giving the Commissioner of Taxation (Commissioner) the power to extend the time for a taxpayer to object to an assessment *before* the original objection timeframe has expired;
 - (b) Aligning the processes for disputing substantive tax, penalty and interest decisions (currently, certain interest decisions can only be reviewed by the Federal Court under the *Administrative Decisions (Judicial Review) Act 1977*);
 - (c) Providing the Commissioner with a "compromise assessment" mechanism similar to that available to the state revenue authorities (see for example s. 12 of the *Taxation Administration Act 1997* (Vic)). Currently, settlements are sometimes constrained by the need to find a "principled basis". Such a mechanism would provide greater flexibility to the ATO and make it easier, cheaper and more efficient to resolve tax disputes, for example on the basis of uncertainty or litigation risk; and
 - (d) Introducing a legislative right of early engagement which can be triggered by the taxpayer. Such a legislative mechanism could formally require the Commissioner to engage in ADR at the request of the taxpayer, rather than him only doing so by virtue of his internal policies. We acknowledge that further consideration would be required as to how the legislation should describe the time at which this right of early engagement would be available.

31. Although there may be merit for a separate review focussing only on this area, there would be benefit in the Committee considering this, even if only at a high level, as part of the current Inquiry.

Conclusion

32. The Institute, along with its expert members in the area of dispute resolution, would be pleased to provide additional details on any of the matters set out above or to address the Committee more generally, either in writing, by phone or in person.
33. If you would like to discuss this matter, please contact me or Tax Counsel, Thilini Wickramasuriya on [REDACTED].

Yours sincerely,

[REDACTED]

Michael Flynn
President